

Montgomery County Employee Retirement Plans

Comprehensive Annual Financial Report



Employees' Retirement System Retirement Savings Plan Deferred Compensation Plan (Trust Funds of Montgomery County, Maryland)

Fiscal Year 2004
July 1, 2003 – June 30, 2004

Prepared by the Board of Investment Trustees
11 North Washington Street, Suite 250
Rockville, Maryland 20850

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Montgomery County
Employees Retirement Plans,
Maryland

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

Montgomery County Employee Retirement Plans

Comprehensive Annual Financial Report



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Montgomery County, Maryland
EMPLOYEE RETIREMENT PLANS
Fiscal Year Ended June 30, 2004
TABLE OF CONTENTS

Introduction Section	Page
Letter of Transmittal	4
Board of Investment Trustees	8
Administrative Organization	9
Organization Chart	10
 Financial Section	
Independent Auditors' Report	12
Management's Discussion and Analysis	15
Financial Statements	
Statements of Plan Net Assets	20
Statements of Changes in Plan Net Assets	21
Notes to Financial Statements	22
Required Supplementary Information	
Schedule of Funding Progress	30
Schedule of Employer Contributions	30
Notes to Required Supplementary Information	31
Schedule of Administrative, Investment and Professional Fees	32
Employees' Retirement System	
Statements of Plan Net Assets	34
Statements of Changes in Plan Net Assets	35
Retirement Savings Plan	
Statements of Plan Net Assets	36
Statements of Changes in Plan Net Assets	37
Deferred Compensation Plan	
Statements of Plan Net Assets	38
Statements of Changes in Plan Net Assets	39
 Investment Section - Employees' Retirement System	
Investment Performance, Policy, Statistics and Activity	43
Investment Summary - Asset Allocation By Category and Investment Manager	44
Asset Allocation	45
List of Largest Assets Held	46
Schedule of Investment Results	47
Compound Annual Return on Investment Portfolio	48
 Actuarial Section - Employees' Retirement System	
Actuary's Certification Letter	50
Summary of Valuation Results	54
Summary of Actuarial Assumptions and Methods	59
Actuarial Assumptions and Methods	60
Analysis of Financial Experience	64
Solvency Test	64
Schedule of Retirees and Survivors	65
 Statistical Section - Employees' Retirement System	
Schedule of Additions by Source	67
Schedule of Deductions by Type	67
Schedule of Benefit Payments by Type	68
Schedule of Retired Members by Benefit Type	68
Schedule of Average Benefit Amounts	68
Schedule of Participating Agencies and Political Subdivisions	69





INTRODUCTION SECTION



OFFICES OF THE COUNTY EXECUTIVE

Douglas M. Duncan
County Executive

December 7, 2004

Bruce Romer
Chief Administrative Officer

Honorable County Executive and
Members of the Montgomery County Council

I am pleased to present to you the Comprehensive Annual Financial Report (CAFR) of the Montgomery County, Maryland (County) Employee Retirement Plans (Plans) for the fiscal year ended June 30, 2004. This annual report is designed to assist you in understanding the structure and current status of the Plans.

This report was prepared pursuant to the provisions of Section 33-51(b) of the Montgomery County Code, 2001, as amended (Code), and includes the independent auditors' report, issued by the County Council's appointed independent public accounting firm. Responsibility for the accuracy of the presented data and the completeness and fairness of the presentation including all disclosures rests with the County. We believe the data, as presented, is accurate in all material respects; that it is presented in a manner designed to fairly set forth the plan net assets and the changes in plan net assets and financial position of the Plans; and that all disclosures necessary to enable the reader to gain the maximum understanding of the financial affairs of the Plans have been included.

The accompanying report consists of five sections: an **Introduction Section** which contains the Certificate of Achievement, this transmittal letter, and the organization structure; a **Financial Section** which contains the report of the independent auditors, the management's discussion and analysis, the financial statements of the Plans and required supplementary information; an **Investment Section** which contains investment results for the Employees' Retirement System (System) defined benefit pension plan; an **Actuarial Section** which contains the independent actuary's certification letter, a summary of the results of the actuarial valuation, including actuarial procedures and assumptions for the System; and a **Statistical Section** which contains information on the System's membership.

History

The System was established in 1965, as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of the County and other agencies or political subdivisions who elect to participate. Participating agencies and subdivisions include the: Montgomery County Revenue Authority, Housing Opportunities Commission of Montgomery County, independent fire/rescue corporations, Town of Chevy Chase, Strathmore Hall Foundation, Inc., Washington Suburban Transit Commission, and certain employees of the State Department of Assessments and Taxation and the District Court of Maryland. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. There were 5,670 active members and 4,559 retirees participating in the System as of June 30, 2004.

The Retirement Savings Plan (RSP) was established in 1994, as a cost-sharing multiple-employer defined contribution plan providing benefits to all non-public safety and certain public safety employees hired on or after October 1, 1994. Employees covered by the System may make an irrevocable decision to transfer to the RSP. At June 30, 2004, there were 3,521 active plan members.



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www.co.mo.md.us



The Deferred Compensation Plan (457 Plan) was established pursuant to Section 457 of the Internal Revenue Code, as amended. During Fiscal Year (FY) 1999, in accordance with Federal legislation, the assets of the 457 Plan were placed in trust for the sole benefit of participants and their beneficiaries.

Benefit Provisions

The benefit provisions of the System are established by the Code. The System provides for normal service retirement and early service retirement benefits for members who attain age and service requirements. The System also provides options for disability and death benefits to eligible participants. Members are vested after five years of service.

The RSP provides for immediate vesting of employee contributions and employer contributions are vested after three years of service or upon death, disability or reaching retirement age.

Major Initiatives

During FY 2004, the Board of Investment Trustees (Board) restructured the System investments among asset classes and investment managers as follows:

- Domestic Equity – hired and funded a new small capitalization value manager.
- International Equity – increased exposure to emerging markets.
- Fixed Income – reduced exposure to core bond managers.
- Treasury Inflation Protection Securities (TIPS) – increased exposure to asset class and expanded the mandate from domestic to global.
- Alternative Investments – hired and funded a second private equity manager.

The Board hired a Third-Party Administrator to provide administrative services and mutual fund investment offerings to participants of the 457 Plan resulting in lower costs and stronger fund options.

In addition, the Board expanded the mutual fund options available in the Retirement Savings Plan by adding four additional lifestyle funds.

Financial Information

Accounting System and Reports

The Plans' financial statements have been prepared under the accrual basis of accounting. Contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plans.

Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A), which can be found on pages 15 to 19 of this report, provides a brief analysis of the financial performance of the Plans and an introduction to the financial statements of the Plans for the year ended June 30, 2004.

Investments

Montgomery County has established a Board to be responsible for the investment management of the Plans' assets for the exclusive benefit of the members and participants. The Board consists of nine members appointed by the County Council.

In overseeing the management of the assets of the Plans, the Board has developed sound and prudent investment policies. The Board believes an appropriate balance must be struck between risks taken and returns sought to ensure the long term health of the defined benefit plan. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets. To achieve this objective, System assets are allocated to a broad array of investment sectors as follows: domestic equities 45 percent, alternative investments 5 percent, international equities 15 percent, domestic fixed income 25 percent, and TIPS 10 percent. For the twelve months ended June 30, 2004, the total return achieved by the System's investments was 17.16 percent, compared to the System's benchmark index return of 15.66 percent and the actuarial assumed rate of return of 8.0 percent.

Section 33-125 of the Montgomery County Code authorizes the Board to establish, for members of the RSP, a diversified slate of mutual and commingled investment funds from which participants may select options. The Board has developed a statement of policies and objectives outlining its oversight of the investment products offered.

The Board has also established a diversified slate of mutual and commingled funds for the 457 Plan which offers a range of options from which participants may select. The Board has constructed an investment policy stipulating investment objectives and oversight by the Board.

Funding

The System's actuary uses a five-year smoothed market-related value to determine the actuarial value of assets. The smoothing prevents extreme volatility in employer contribution rates due to short-term fluctuations in the investment markets. For the June 30, 2004 valuation, the actuarial value of assets was \$2.0 billion. The aggregate actuarial liability was \$2.6 billion. The Schedule of Funding Progress included as Required Supplementary Information in the Financial Section, expresses the System's actuarial value of assets as a percentage of the actuarial accrued liability, providing one indication of the System's funding status on a going-concern basis. The actuary has determined that the present net asset base, expected future contributions and investment earnings thereon, are sufficient to provide for full payment of future benefits under the projected unit credit actuarial cost method.

Internal Control Structure and Budgetary Controls

The Plans' management is responsible for maintaining internal accounting controls to provide reasonable assurance that transactions are properly authorized and recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America. We believe the internal controls in effect during the fiscal year ended June 30, 2004 adequately safeguard the Plans' assets and provide reasonable assurance regarding the proper recording of financial transactions. In addition, the Board, in conjunction with the Chief Administrative Officer, approves and actively monitors the annual budgets for each plan.

Independent Audit and Actuarial Certification

An independent auditors' report and actuarial certification are included in this report.

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Montgomery County Employee Retirement Plans for its comprehensive annual financial report for the fiscal year ended June 30, 2003. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such a report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The Montgomery County Employee Retirement Plans have received the Certificate of Achievement for the last four consecutive years. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement program requirements and we are submitting it to the GFOA.

Acknowledgements

The Plans' CAFR was prepared by the Board of Investment Trustees staff in conjunction with staff support from the County's Department of Finance and Office of Human Resources. I would like to express my appreciation to the employees who have worked hard throughout the year to ensure the successful operation of the Plans.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'B. Romer', is written over a horizontal line.

Bruce Romer
Chief Administrative Officer

BOARD OF INVESTMENT TRUSTEES

Stephen B. Farber

Chair

Montgomery County Council Staff Director

Ex-Officio Member

Arthur W. Spengler

Vice Chair

Retired Employees Representative

Term Expires March 2006

Sandra P. Kaiser

Secretary

Montgomery County

Department of Permitting Services

Non-Bargaining Unit Representative

Term Expires March 2005

Mark A. Barnard

Montgomery County Council Representative

Term Expires March 2006

Sharon M. Cayelli

Citizen Representative

Term Expires March 2005

Timothy L. Firestine

Montgomery County Director of Finance

Ex-Officio Member

Joseph Adler

Montgomery County Director of

Human Resources

Ex-Officio Member

Gino Renne

Employee Organization Representative

Term Expires March 2007

Beverley Swaim-Staley

Montgomery County Director of

Management and Budget

Ex-Officio Member

ADMINISTRATIVE ORGANIZATION

Administrative Staff

Joseph Adler
Director – Office of
Human Resources

Timothy L. Firestine
Director of Finance

Linda A. Herman
Executive Director

Professional Services

Actuary

Mercer Human Resource
Consulting
Washington, DC

Investment Consultant

Wilshire Associates
Santa Monica, CA

Auditor

KPMG LLP
Certified Public Accountants
Washington, DC

Investment Managers-Employees' Retirement System

Capital Guardian Trust Company
Los Angeles, CA

Adams Street Partners
Chicago, IL

Marathon London
United Kingdom

Wellington Management
Boston, MA

RhumbLine Advisors
Boston, MA

Numeric Investors
Cambridge, MA

Systematic Financial Management
Teaneck, NJ

Fidelity Investments
Hebron, KY

BlackRock Financial Management Inc.
New York, NY

WR Huff Asset Management Co.
Morristown, NJ

JP Morgan Investment Management
New York, NY

Goldman Sachs
New York, NY

Bridgewater Associates
Westport, CT

Barclays Global Investors
San Francisco, CA

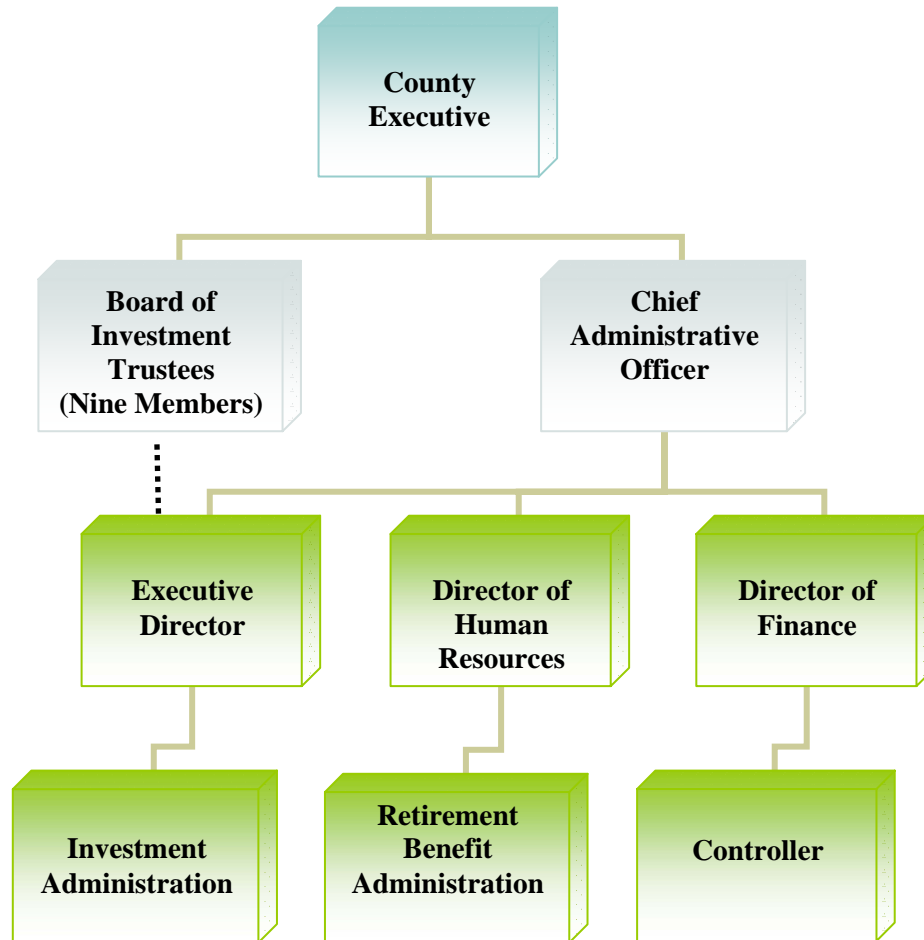
HarbourVest Partners
Boston, MA

Morgan Stanley Asset Management
New York, NY

Custodial Bank-Employees' Retirement System

The Northern Trust Company
Chicago, IL

Organization Chart





FINANCIAL SECTION



KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

The County Council of Montgomery County, Maryland

The Board of Trustees
Montgomery County Employees' Retirement Plans:

We have audited the accompanying statements of plan net assets of the Montgomery County Employees' Retirement Plans (the Plans) as of June 30, 2004 and the related statements of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Plans' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Plans as of June 30, 2004 and the changes in the plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 15 through 19 and the schedule of funding progress and notes thereto, on pages 30 and 31, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the 2004 basic financial statements taken as a whole. The 2004 supplementary information on pages 32 through 39 is presented for purposes of additional analysis and is not a required part of the 2004 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2004 basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the 2004 basic financial statements taken as whole. The information included in the introduction, investment, actuarial, and statistical sections has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we express no opinion on such information.



We have also previously audited, in accordance with auditing standards generally accepted in the United States of America, the statements of plan net assets of the Plans as of June 30, 2003, and the related statements of changes in plan net assets for the year then ended (none of which is presented herein), and we expressed an unqualified opinion on those financial statements. The supplementary information included on pages 34 through 39 related to the Plans' 2003 financial statements was subjected to auditing procedures applied in the audit of those basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements from which it has been derived.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2004 on our consideration of the Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

KPMG LLP

December 3, 2004



MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The following Management's Discussion and Analysis (MD&A) of the Montgomery County Employee Retirement Plans (Plans) financial performance provides an introduction to the financial statements of the Plans as of and for the year ended June 30, 2004. Since the MD&A is designed to focus on current activities, resulting changes and current known facts, please read it in conjunction with the transmittal letter in the Introduction Section on page 4, the financial statements, required supplementary information, and other supplementary information which follow this discussion.

Required Financial Statements

The financial statements for the Plans have been prepared under the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, promulgated by the Governmental Accounting Standards Board. The Statements of Plan Net Assets comprise the Plans' assets and liabilities and provide information about the nature and amount of investments, as well as the liabilities distinguished as long-term and other liabilities. The Statements of Changes in Plan Net Assets report the changes of the Plans' net assets, measured by the additions by major sources and deductions by type. Comparative financial statements of the three plans are presented in the latter part of the financial section.

Financial Analysis of the Montgomery County Employee Retirement Plans

Shown below is a condensed presentation of the Net Assets of the Employees' Retirement System (ERS), Retirement Savings Plan (RSP), and Deferred Compensation Plan (DCP) at June 30:

Net Assets (Millions)						
	ERS		RSP		DCP	
	2004	2003	2004	2003	2004	2003
Assets:						
Cash and investments	\$ 2,268.1	\$ 1,953.0	\$ 54.9	\$ 39.7	\$ 239.9	\$ 198.7
Receivables	10.5	9.2	0.7	0.5	1.1	0.9
Total assets	<u>2,278.6</u>	<u>1,962.2</u>	<u>55.6</u>	<u>40.2</u>	<u>241.0</u>	<u>199.6</u>
Liabilities	<u>303.0</u>	<u>235.7</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total net assets	<u>\$ 1,975.6</u>	<u>\$ 1,726.5</u>	<u>\$ 55.6</u>	<u>\$ 40.2</u>	<u>\$ 241.0</u>	<u>\$ 199.6</u>

Shown below is a condensed summary of the Change in Net Assets of all Plans for the years ended June 30:

Change in Net Assets (Millions)						
	ERS		RSP		DCP	
	2004	2003	2004	2003	2004	2003
Additions:						
Employer contributions	\$ 61.9	\$ 55.2	\$ 6.5	\$ 6.8	\$ -	\$ -
Member contributions	14.8	14.8	4.2	3.7	21.6	21.1
Net investment income	286.9	82.1	6.3	2.0	29.4	4.6
Total additions	<u>363.6</u>	<u>152.1</u>	<u>17.0</u>	<u>12.5</u>	<u>51.0</u>	<u>25.7</u>
Deductions:						
Benefits	111.6	100.4	-	-	-	-
Refunds	0.8	0.7	1.4	0.9	9.6	11.1
Administrative expenses	2.1	2.0	0.2	0.2	-	-
Total deductions	<u>114.5</u>	<u>103.1</u>	<u>1.6</u>	<u>1.1</u>	<u>9.6</u>	<u>11.1</u>
Total change in net assets	<u>\$ 249.1</u>	<u>\$ 49.0</u>	<u>\$ 15.4</u>	<u>\$ 11.4</u>	<u>\$ 41.4</u>	<u>\$ 14.6</u>

The following schedules provide a comparative summary and an analysis of each Plans' assets, liabilities and net assets, at June 30:

Employees' Retirement System Net Assets (Millions)			
	2004	2003	Percentage Change
Assets:			
Cash and investments	\$ 2,268.1	\$ 1,953.0	16.1 %
Receivables	10.5	9.2	14.1
Total assets	<u>2,278.6</u>	<u>1,962.2</u>	16.1
Liabilities:			
Benefits payable and other liabilities	2.7	2.3	17.4
Obligations under securities lending agreements	<u>300.3</u>	<u>233.4</u>	28.7
Total liabilities	<u>303.0</u>	<u>235.7</u>	28.6
Total plan net assets	<u>\$ 1,975.6</u>	<u>\$ 1,726.5</u>	14.4 %

The table shown above reflects an increase in the Employees' Retirement System's net assets of \$249.1 million or 14.4 percent during fiscal year (FY) 2004. The increase reflects improved market conditions over the last twelve months resulting in increased investment earnings. During the previous year net assets increased by \$49 million.

Retirement Savings Plan Net Assets (Millions)				
	2004	2003	Percentage Change	
Assets:				
Cash and investments	\$ 54.9	\$ 39.7	38.3	%
Receivables	0.7	0.5	40.0	
Total assets	<u>55.6</u>	<u>40.2</u>	38.3	
Liabilities	-	-	-	
Total plan net assets	<u>\$ 55.6</u>	<u>\$ 40.2</u>	38.3	%

During FY 2004, net assets increased 38.3 percent to \$55.6 million. The increase is attributable to increased investment earnings. Membership in the Retirement Savings Plan rose from 3,206 at June 30, 2003, to 3,521 at June 30, 2004.

Deferred Compensation Plan Net Assets (Millions)				
	2004	2003	Percentage Change	
Assets:				
Investments	\$ 239.9	\$ 198.7	20.7	%
Receivables	1.1	0.9	22.2	
Total assets and plan net assets	<u>\$ 241.0</u>	<u>\$ 199.6</u>	20.7	%

Net assets of the Deferred Compensation Plan increased 20.7 percent to \$241 million during FY 2004. The increase is attributable to an increase in investment earnings due to improved market conditions.

Additions

The primary sources of additions for the Plans include member and employer (where applicable) contributions and investment income. The following tables show the source and amount of additions for each Plan during FY 2004 and FY 2003.

Employees' Retirement System Contributions and Investment Income (Millions)				
	2004	2003	Percentage Change	
Employer contributions	\$ 61.9	\$ 55.2	12.1	%
Member contributions	14.8	14.8	-	
Net investment income	286.9	82.1	249.5	
	<u>\$ 363.6</u>	<u>\$ 152.1</u>	139.1	%

During FY 2004, employer contributions to the Employees' Retirement System increased by 12.1 percent due to an increase in the actuarial required contribution based on covered payroll. Member contributions remained substantially the same.

The net investment income for the Employees' Retirement System totaled \$286.9 million for FY 2004, comprised of \$249.1 million in net appreciation in fair value of investments, \$43.7 million in dividends and interest, \$2.9 million from securities lending activities, and \$8.8 million related to investment expenses. This is compared to net investment income of \$82.1 million in FY 2003.

Retirement Savings Plan			
Contributions and Investment Income			
(Millions)			
	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Employer contributions	\$ 6.5	\$ 6.8	(4.4) %
Member contributions	4.2	3.7	13.5
Net investment income	<u>6.3</u>	<u>2.0</u>	215.0
	<u>\$ 17.0</u>	<u>\$ 12.5</u>	36.0 %

Employer contributions to the Retirement Savings Plan were \$6.5 million in FY 2004, a decrease of 4.4 percent from FY 2003. In accordance with IRS 457 regulations, and the County Code, \$1.2 million in accumulated revenue was used to reduce employer contributions in FY 2004. Member contributions were \$4.2 million in FY 2004, an increase of 13.5 percent from FY 2003. The increase in contributions reflects the increase in the number of participants during FY 2004.

Appreciation in investments reflects the current market conditions.

Deferred Compensation Plan			
Contributions and Investment Income			
(Millions)			
	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Member contributions	\$ 21.6	\$ 21.1	2.4 %
Net investment income	<u>29.4</u>	<u>4.6</u>	539.1
	<u>\$ 51.0</u>	<u>\$ 25.7</u>	98.4 %

Member contributions to the Deferred Compensation Plan were \$21.6 million for FY 2004, a slight increase compared to \$21.1 million for FY 2003.

Net investment income for the Deferred Compensation Plan was \$29.4 million in FY 2004, compared to the investment income of \$4.6 million in the previous fiscal year, which was primarily due to improved market conditions.

Deductions

The primary sources of deductions from the Plans include the payment of retiree and survivor benefits, participant refunds, and administrative expenses. The following tables show the use and amount of deductions for each plan during FY 2004 and FY 2003.

Employees' Retirement System			
Deductions by Type			
(Millions)			
	2004	2003	Percentage Change
Benefits	\$ 111.6	\$ 100.4	11.2 %
Refunds	0.8	0.7	14.3
Administrative expenses	2.1	2.0	5.0
	<u>\$ 114.5</u>	<u>\$ 103.1</u>	11.1 %

During FY 2004, benefit payments increased by 11.2 percent over FY 2003 due primarily to an increase in the number of retirees. Refunds paid increased by 14.3 percent over FY 2003. Administrative expenses increased slightly in FY 2004 from \$2.0 million in FY 2003 to \$2.1 million in FY 2004.

Retirement Savings Plan			
Deductions by Type			
(Millions)			
	2004	2003	Percentage Change
Refunds and administrative expenses	<u>\$ 1.6</u>	<u>\$ 1.1</u>	45.5%

The expenses related to the Retirement Savings Plan are comprised of refunds and administrative costs. Expenses for FY 2004 totaled \$1.6 million, an increase of 45.5 percent over FY 2003 levels due primarily to an increase in refunds.

Deferred Compensation Plan			
Deductions by Type			
(Millions)			
	2004	2003	Percentage Change
Refunds and administrative expenses	<u>\$ 9.6</u>	<u>\$ 11.1</u>	(13.5)%

During FY 2004, refunds distributed from the Deferred Compensation Plan decreased by 13.5 percent over the FY 2003 level.

MONTGOMERY COUNTY, MARYLAND
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2004

	Employees' Retirement System	Retirement Savings Plan	Deferred Compensation Plan
ASSETS			
Equity in County's pooled cash and investments	\$ 533,502	\$ 524,214	\$ -
Investments:			
U.S. Government and agency obligations	224,583,856	-	-
Asset-backed securities	25,130,943	-	-
Municipal/Provincial bonds	745,819	-	-
Corporate bonds	283,610,976	-	-
Collateralized mortgage obligations	3,308,835	-	-
Commercial mortgage-backed securities	3,214,617	-	-
Common and preferred stock	1,319,682,926	-	-
Mutual and commingled funds	580,139	54,446,315	239,923,463
Short-term investments	96,168,794	-	-
Cash collateral received under securities lending agreements	300,257,113	-	-
Real estate holdings	3,697,613	-	-
Alternative investments	6,563,331	-	-
Total investments	2,267,544,962	54,446,315	239,923,463
Dividends receivable and accrued interest	6,630,325	-	-
Contributions receivable	3,893,796	684,896	1,092,852
Total assets	2,278,602,585	55,655,425	241,016,315
LIABILITIES			
Payable for collateral received under securities lending agreements	300,257,113	-	-
Benefits payable and other liabilities	2,726,501	39,996	-
Total liabilities	302,983,614	39,996	-
Net assets held in trust for pension benefits	<u>\$ 1,975,618,971</u>	<u>\$ 55,615,429</u>	<u>\$ 241,016,315</u>

(A schedule of funding progress for the Employees' Retirement System is presented on page 30.)
See accompanying notes to financial statements.

MONTGOMERY COUNTY, MARYLAND
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2004

	Employees' Retirement System	Retirement Savings Plan	Deferred Compensation Plan
ADDITIONS			
Contributions:			
Employer	\$ 61,927,029	\$ 6,468,353	\$ -
Members	14,761,912	4,208,196	21,610,024
Total contributions	<u>76,688,941</u>	<u>10,676,549</u>	<u>21,610,024</u>
Investment income	295,722,750	6,432,959	29,455,876
Less investment expenses	<u>8,827,650</u>	<u>79,070</u>	<u>-</u>
Net investment income	<u>286,895,100</u>	<u>6,353,889</u>	<u>29,455,876</u>
Total additions	<u>363,584,041</u>	<u>17,030,438</u>	<u>51,065,900</u>
DEDUCTIONS			
Retiree benefits	87,122,662	-	-
Disability benefits	5,031,935	-	-
Survivor benefits	19,491,388	-	-
Refunds	796,099	1,382,451	9,634,643
Administrative expenses	<u>2,066,265</u>	<u>247,277</u>	<u>5,564</u>
Total deductions	<u>114,508,349</u>	<u>1,629,728</u>	<u>9,640,207</u>
Net increase	<u>249,075,692</u>	<u>15,400,710</u>	<u>41,425,693</u>
Net assets held in trust for pension benefits:			
Beginning of year	<u>1,726,543,279</u>	<u>40,214,719</u>	<u>199,590,622</u>
End of year	<u>\$ 1,975,618,971</u>	<u>\$ 55,615,429</u>	<u>\$ 241,016,315</u>

See accompanying notes to financial statements.

**MONTGOMERY COUNTY EMPLOYEE RETIREMENT PLANS
NOTES TO FINANCIAL STATEMENTS**

YEAR ENDED JUNE 30, 2004

INTRODUCTION

The Montgomery County Employee Retirement Plans (Plans) are offered to Montgomery County (County) employees whose eligibility to participate is based on employment status and other factors. Each of the Plans described below was established under a separate section of the Montgomery County Code (Code). The accompanying notes summarize the significant accounting policies and plan provisions for each of the Plans, including the Employees' Retirement System, a defined benefit pension plan; the Retirement Savings Plan, a defined contribution plan; and the Deferred Compensation Plan, a plan established pursuant to Section 457 of the Internal Revenue Code.

EMPLOYEES' RETIREMENT SYSTEM - Defined Benefit Pension Plan

The Montgomery County Employees' Retirement System (System or Plan) is considered part of the County's financial reporting entity and is included in the County's basic financial statements as a pension and other employee benefit trust fund. The accompanying financial statements present only the operations of the System in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to public employee retirement systems. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Membership. At June 30, 2004, the date of the latest actuarial valuation, membership in the System consisted of:

Retirees and beneficiaries receiving benefits	4,559
Terminated plan members entitled to but not yet receiving benefits	367
Active plan members	5,670

Plan Description. The System, a cost-sharing multiple-employer defined benefit pension plan, was established in 1965 and is sponsored by the County. Other agencies or political subdivisions have the right to elect participation. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. All covered full-time employees of the County and participating agencies must become members of the System as a condition of employment. All covered career part-time employees of the County and participating agencies may become members on an individual basis.

Funding Policy and Contributions. The System is a contributory plan with employees contributing a percentage of their base annual salary. Contribution rates range from 4 percent to 8.5 percent of regular earnings annually based on group classification and contributions earn interest at the rate of 4 percent per annum as specified under Section 33-39(b) of the Code. The County and each participating agency are required to contribute the remaining amounts necessary to fund the System using the actuarial basis as specified in Section 33-40 of the Code.

Benefit Provisions. Benefit provisions are established under the Code beginning with Section 33-35. All benefits vest at five years of service. There are different retirement groups within the System. Members enrolled before July 1, 1978, belong to either the optional non-integrated group or the optional integrated group. Members enrolled on or after July 1, 1978, belong to the mandatory integrated group. Within the groups are different retirement membership classes. The retirement group assigned depends upon the job classification of the member (i.e., non public safety, police, fire, sheriffs and correctional staff). Normal and early retirement eligibility, the formula for determining the amount of benefit, and the cost of living adjustment varies depending upon the retirement group and retirement membership class. Normal retirement is a percentage of earnings multiplied by years of credited service. Earnings for optional non-integrated group members and optional integrated group members is defined as the high 12 months and for mandatory integrated plan members, the high 36 months. The percentage of earnings, the maximum years of credited service and the cost of living adjustment varies depending upon the retirement membership class and group. Members who retire early receive normal retirement benefits reduced by a minimum

of 2 percent to a maximum of 60 percent depending on the number of years early retirement precedes normal retirement. The System provides options for disability and death benefits to eligible participants. Annual cost-of-living adjustments are provided to retirees and beneficiaries based on the percentage increase in the Consumer Price Index.

Legislation enacted by the Montgomery County Council in November 1999 required the Chief Administrative Officer of the County to establish Deferred Retirement Option Plans, or DROP Plans, allowing any employee who is a member of a specified membership group or bargaining unit, and who meets certain eligibility requirements, to elect to “retire” but continue to work for a specified time period, during which pension payments are deferred. When the member’s participation in the DROP Plan ends, the member must stop working for the County, draw a pension benefit based on the member’s credited service and earnings as of the date that the member began to participate in the DROP Plan, and receive the value of the DROP Plan payoff. During fiscal year (FY) 2004 total disbursements under the DROP Plan amounted to \$6,801,290.

B. Summary of Significant Accounting Policies

Basis of Accounting. The System’s financial statements have been prepared under the accrual basis of accounting. Member and employer contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plan. The cost of administering the Plan is paid by the System.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2004. Fair value for real estate investments is determined using unit values supplied by the issuers, which are based upon the issuers’ appraisals of underlying real estate values. Such values involve subjective judgment and may differ from amounts which would be realized if such real estate was actually sold. Fair value for the alternative investments is based on information provided by the fund managers. Cash received as collateral on securities lending transactions and investments made with such cash are reported as assets along with a related liability for collateral received.

Equity in County’s Pooled Cash and Investments. The System maintains its cash with the County, which invests cash and allocates interest earned, on a quarterly basis to the System based on the System’s average daily balance of its equity in pooled cash. The County fully collateralizes the cash maintained in the pool.

C. Trustees of the Plan

The County established a Board of Investment Trustees (Board) for the System to be responsible for the investment management of the System’s assets for the exclusive benefit of the members. The Board consists of nine members appointed by the County Executive and confirmed by the County Council.

D. Investments

Section 33-61 of the Code, authorizes the Board to purchase investments with the care, skill, prudence and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes. Such investments shall be diversified so as to minimize the risk of large losses unless it is clearly not prudent to diversify under the circumstances.

Derivatives. The System invests in derivative instruments on a limited basis in accordance with the Board's policy. During FY 2004, the System invested directly in various derivatives including asset-backed securities, collateralized mortgage obligations, bond index future contracts, forward currency contracts, and floating rate securities. Investment managers are specifically prohibited from purchasing securities on margin or leverage. The System entered into these investments either to increase earnings or to hedge against potential losses. These investments generally contain market risk resulting from fluctuations in interest and currency rates. The credit risk of these investments is associated with the creditworthiness of the related parties to the contracts. At June 30, 2004, direct investments in derivatives represented less than one percent of the total fair value of the System's portfolio. In addition, the System has indirect exposure to market and credit risk through its ownership interests in certain mutual funds which hold derivative financial instruments.

Securities Lending. Board policies permit the System to lend its securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The System's custodian is the agent in lending the System's securities for collateral of 102 percent for domestic and 105 percent for international securities. The custodian receives cash, securities or irrevocable bank letters of credit as collateral. All securities loans can be terminated on demand by either the System or the borrower. The relationship between the maturities of the investment pool and the System's loans is affected by the maturities of securities loans made by other plan entities that invest cash collateral in the investment pool, which the System cannot determine.

The System does not restrict the amounts of loans the lending agent may make on its behalf. The agent indemnifies the System by agreeing to purchase replacement securities, or return the cash collateral thereof, in the event a borrower fails to return loaned securities or pay distributions thereon. There were no such failures by any borrower during the fiscal year, nor were there any losses during the period resulting from a default of the borrower or lending agent.

Securities on loan for securities, or irrevocable letters of credit collateral are classified in the following schedule of investments according to the category of the collateral received. As of June 30, 2004, the market value of securities on loan was \$336,733,010. Cash received as collateral and the related liability of \$300,257,113 as of June 30, 2004, is shown on the Statement of Plan Net Assets. Securities received as collateral are not reported as assets since the System does not have the ability to pledge or sell the collateral securities absent borrower default. Securities lending revenues and expenses amounting to \$2,834,615 and \$2,261,886, respectively, have been classified with investment income and investment expenses, respectively, in the accompanying financial statements.

Concentrations. The System does not have investments (other than U.S. Government and U.S. Government guaranteed obligations) in any one organization that represent 5 percent or more of net assets held in trust for pension benefits.

Credit Risk. The System's investments are categorized to give an indication of the level of credit risk assumed by the System at year end. Category 1 includes investments that are insured or registered or for which the securities are held by the System or its agent in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by counterparty's trust department or agent in the System's name. Category 3 includes uninsured and unregistered investments for which the securities are held by counterparty or its trust department or agent, but not in the System's name. All of the System's categorized investments meet the criteria of Category 1. Investments that by their nature are not required to be categorized include mutual funds, commingled funds (pooled investment vehicles), real estate holdings, short-term collateral investment pools and those securities on loan for which the cash collateral is invested in the collateral investment pool.

Schedule of investment as of June 30, 2004:

Categorized investments (Category 1):

Short-term investments	\$ 96,168,794
Asset-backed securities	25,130,943
Corporate bonds:	
Not on securities loan	240,522,059
On securities loan for securities collateral	759,577
U.S. Government obligations:	
Not on securities loan	75,568,455
On securities loan for securities collateral	33,954,926
Common and preferred stock:	
Not on securities loan	1,173,748,212
On securities loan for securities collateral	8,361,376
Collateralized mortgage obligations	3,308,835
Commercial mortgage-backed securities	3,214,617
Municipal/Provincial bonds	745,819
Convertible corporate bonds	<u>1,326,272</u>
 Total categorized investments	 <u>1,662,809,885</u>

Uncategorized investments:

Mutual and commingled funds	580,139
Securities lending short-term collateral investment pool	300,257,113
Investments held by broker dealers under securities loans with cash collateral:	
Common and preferred stock	137,573,338
Corporate bonds	41,003,068
Government obligations	115,060,475
Real estate holdings	3,697,613
Alternative investments	<u>6,563,331</u>
 Total uncategorized investments	 <u>604,735,077</u>
 Total investments	 <u><u>\$ 2,267,544,962</u></u>

E. Allocated Insurance Contract

On August 1, 1986, the County entered into an agreement with Aetna Life Insurance Company (Aetna) wherein Aetna accepted future responsibility for monthly payments to all members retired prior to January 1, 1986, in exchange for a lump sum payment. The County is liable for cost of living increases effective January 1, 1986, and later. Monthly payments made under this agreement have not been recognized in the System's financial statements.

F. Income Taxes

The Internal Revenue Service issued a determination letter in January 2003, which stated that the System and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes. In the opinion of the plan administrator, the System and its underlying trust have operated within the terms of the System and are qualified under the applicable provisions of the Internal Revenue Code.

RETIREMENT SAVINGS PLAN - Defined Contribution Pension Plan

The Montgomery County Retirement Savings Plan (Plan) is considered part of the County's financial reporting entity and is included in the County's basic financial statements as a pension and other employee benefit trust fund. The accompanying financial statements present only the operations of the Plan in conformity with GAAP. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Membership. At June 30, 2004 membership in the Plan consisted of 3,521 active plan members.

Plan Description. The Plan, a cost-sharing multiple-employer defined contribution plan, was established in 1994 and is sponsored by the County. Other agencies or political subdivisions have the right to elect participation. All non-public safety and certain public safety employees not represented by a collective bargaining agreement and hired on or after October 1, 1994 are covered by the Plan. Eligible employees covered by the Montgomery County Employees' Retirement System may make an irrevocable decision to transfer to this Plan.

Contributions. Under Section 33-116 of the Code, the Plan requires employees to contribute 3 percent of regular earnings up to the Social Security wage base and 6 percent above the Social Security wage rate. Section 33-117 of the Code requires the County to contribute 6 percent and 10 percent of regular earnings for non-public safety and public safety employees, respectively. In accordance with IRS 457 regulations, and the County Code, \$1,200,000 in accumulated revenue was used to reduce employer contributions in FY04.

Benefit Provisions. Employee contributions vest immediately and employer contributions are vested after three years of service or upon death, disability, or reaching retirement age. Members are fully vested upon reaching normal retirement (age 62) regardless of years of service. At separation, a participant's benefit is determined based upon the account balance which includes contributions and investment earnings.

B. Summary of Significant Accounting Policies

Basis of Accounting. The Plan's financial statements have been prepared under the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Benefits and refunds are recognized when due in accordance with the terms of the Plan. The cost of administering the Plan is paid by the County and participating agencies.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2004.

Equity in County's Pooled Cash and Investments. The Plan maintains its cash with the County, which invests cash and allocates interest earned, on a quarterly basis to the Plan based on the Plan's average daily balance of its equity in pooled cash. The County fully collateralizes the cash maintained in the pool.

C. Trustees of the Plan

The County established a Board of Investment Trustees (Board) for the Trust to oversee the investment program. The Board consists of nine members appointed by the County Executive and confirmed by the County Council.

D. Investments

Section 33-125 of the Code authorizes the Board to establish a diversified slate of mutual and commingled investment funds from which participants may select an option. The Board exercises the Standard of Care as delineated in Section 33-61 of the Code. The Plan's investments are categorized to give an indication of the level of credit risk assumed by the Plan at year end. Category 1 includes investments that are insured or registered or for which the securities are held by the Plan or its agent in the Plan's name. Category 2 includes uninsured and unregistered investments for which the securities are held by counterparty's trust department or agent in the Plan's name. Category 3 includes uninsured and unregistered investments for which the securities are held by counterparty or its trust department or agent, but not in the Plan's name. All of the Plan's investments include mutual and commingled funds (pooled investment vehicles) and are therefore not required to be categorized.

Schedule of investments as of June 30, 2004:

Uncategorized Investments - Mutual and commingled funds	\$54,446,315
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E. Income Taxes

The Internal Revenue Service issued a determination letter in December 2002, which stated that the Plan and its underlying trust qualify under the applicable provisions of the Internal Revenue Code and therefore are exempt from federal income taxes. In the opinion of the plan administrator, the Plan and its underlying trust have operated within the terms of the Plan and are qualified under the applicable provisions of the Internal Revenue Code.

DEFERRED COMPENSATION PLAN

The employees of the County may participate in the Montgomery County Deferred Compensation Plan (the 457 Plan). The purpose of the Plan is to extend to employees a deferred compensation plan pursuant to Section 457 of the Internal Revenue Code of 1954, as amended. During 1999, in accordance with Federal legislation, the assets of the 457 Plan were placed in trust for the sole benefit of participants and their beneficiaries. The accompanying financial statements present only the operations of the 457 Plan in conformity with GAAP. They are not intended to present fairly the financial position and results of operations of the entire County.

A. Plan Description and Contribution Information

Plan Description and Contributions. The Board of Investment Trustees (Board) has contracts with The Hartford and Fidelity Investments to provide investment vehicles for plan participants. Under the 457 Plan, contributions are sent to the providers for different types of investments as selected by the participants. A separate account, which reflects the monies deferred, investment of the monies, and related investment earnings is maintained for each participant by the provider. Withdrawals are made upon retirement, termination of employment, death, and/or in unforeseeable emergencies.

B. Summary of Significant Accounting Policies

Basis of Accounting. The 457 Plan's financial statements have been prepared under the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Distributions are recognized when paid in accordance with the terms of the 457 Plan, and administrative costs are recognized as incurred.

Method Used to Value Investments. Investments are stated at fair value. The fair value is generally based on quoted market prices at June 30, 2004.

C. Trustees of the Plan

The County established a Board to oversee the investment program of the 457 Plan. The Board consists of nine members appointed by the County Executive and confirmed by the County Council.

D. Investments

The Board is required to establish a diversified slate of mutual and commingled funds from which participants may select investment options. The Board exercises the Standard of Care as delineated in Section 33-61 of the Code. The 457 Plan's investments are categorized to give an indication of the level of risk assumed by the plan at year end. Category 1 includes investments that are insured or registered or for which the securities are held by the Plan or its agent in the Plan's name. Category 2 includes uninsured and unregistered investments for which the securities are held by counterparty's trust department or agent in the Plan's name. Category 3 includes uninsured and unregistered investments for which the securities are held by counterparty or its trust department or agent, but not in the Plan's name. All of the Plan's investments include mutual and commingled funds (pooled investment vehicles) and are therefore not required to be categorized.

Schedule of investments as of June 30, 2004:

Uncategorized Investments - Mutual and commingled funds	\$239,923,463
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REQUIRED SUPPLEMENTARY INFORMATION

Historical trend information about the Employees' Retirement System (System) defined benefit pension plan is presented below as required supplementary information. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employee retirement systems.

SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
6/30/99	\$ 1,707,450,187	\$1,818,990,623	\$111,540,436	93.9 %	\$ 282,220,066	39.5 %
6/30/00	1,911,114,401	1,931,914,313	20,799,912	98.9	299,649,316	6.9
6/30/01	1,990,882,017	2,111,946,453	121,064,436	94.3	290,751,709	41.6
6/30/02	2,036,100,709	2,273,179,216	237,078,507	89.6	298,456,852	79.4
6/30/03	2,029,314,438	2,411,492,724	382,178,286	84.2	312,057,363	122.5
6/30/04	2,045,098,796	2,561,328,232	516,229,436	79.8	318,815,374	161.9

Analysis of the dollar amounts of plan net assets, actuarial accrued liability, and unfunded actuarial accrued liability in isolation can be misleading. Expressing the assets as a percentage of the actuarial accrued liability provides one indication of the System's funding status on a going-concern basis. Analysis of this percentage over time indicates whether the system is becoming financially stronger or weaker. Generally, the greater this percentage, the stronger the system. Trends in the unfunded actuarial accrued liability and annual covered payroll are both affected by inflation. Expressing the unfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effects of inflation and aids analysis of the system's progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage, the stronger the system.

SCHEDULE OF EMPLOYER CONTRIBUTIONS

Fiscal Year Ended June 30	Annual Required Contribution	Percentage Contributed
1999	\$ 47,462,625	100 %
2000	44,347,078	100
2001	43,345,296	100
2002	39,168,622	100
2003	55,205,855	100
2004	61,927,029	100

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

The information presented in the required supplementary schedules was determined as part of the actuarial valuation at the date indicated. Additional information as of the latest actuarial valuation follows.

Valuation date	June 30, 2004
Actuarial cost method	Projected unit credit
Amortization method	Level dollar amount
Remaining amortization period	40 year period based on closed periods
Asset valuation method	5-Year phase-in of market gains/losses
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	4.0%
Cost-of-living adjustments	4.0%
Post-Retirement Increases	Consumer Price Index - by Group
Mortality rates after retirement	Group Annuity - 1983 table

The actuarial assumptions used have been recommended by the actuary and adopted by the County's Chief Administrative Officer based on the most recent review of the System's experience, completed as of June 30, 2004.

The rate of employer contributions to the plan is composed of the normal cost, amortization of the unfunded actuarial liability and an allowance for administrative expenses. The normal cost is a level percent of pay cost which, along with the member contributions, will pay for projected benefits at retirement for the average plan participant. The actuarial liability is that portion of the present value of projected benefits that will not be paid by future employer normal costs or member contributions. The difference between this liability and the funds accumulated as of the same date is the unfunded actuarial liability.

SCHEDULE OF ADMINISTRATIVE, INVESTMENT AND PROFESSIONAL FEES
EMPLOYEES' RETIREMENT SYSTEM
FOR THE YEAR ENDED JUNE 30, 2004

SCHEDULE OF ADMINISTRATIVE EXPENSES

Personnel Services:	
Salaries and wages	\$ 648,465
Retirement contributions	70,443
Insurance	66,554
Social security	58,564
Total personnel services	<u>844,026</u>
Professional Services:	
Actuarial	362,214
Independent public accountants	25,680
Outside legal	17,153
Intern	3,560
Total professional services	<u>408,607</u>
Benefit Processing:	
Disbursement services	352,039
Disability management	253,973
Total benefit processing	<u>606,012</u>
Due diligence and continuing education	<u>6,481</u>
Office Management:	
Rent and related charges	85,147
Communications	30,101
Office equipment and supplies	78,589
Miscellaneous	7,302
Total office management	<u>201,139</u>
Total administrative expenses	<u>\$ 2,066,265</u>

SCHEDULE OF PROFESSIONAL SERVICES FEES

Professional Services Fees:	
Mercer Human Resource Consulting	\$ 362,214
KPMG LLP	25,680
Total professional services fees	<u>\$ 387,894</u>

(Continued)

SCHEDULE OF ADMINISTRATIVE, INVESTMENT AND PROFESSIONAL FEES, CONCLUDED
EMPLOYEES' RETIREMENT SYSTEM
FOR THE YEAR ENDED JUNE 30, 2004

SCHEDULE OF INVESTMENT EXPENSES

Investment Management Fees:

Aetna Life Insurance Company	\$	4,199
The Northern Trust Company		268,882
Marathon London		909,810
BlackRock Financial Management Inc.		465,719
Wellington Management Company		364,286
Bridgewater Associates		246,596
RhumbLine Advisors		65,075
Systematic Financial Management		519,324
William Blair & Company		129,741
Barclays Global Investments		61,630
Numeric Investors		1,167,099
WR Huff Asset Management Co.		558,499
JP Morgan Investment Management		484,931
Capital Guardian Trust Company		691,255
Goldman Sachs		393,370
Fidelity Investments		214

Total investment management fees		<u>6,330,630</u>
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Other Investment Related Expenses:

Bloomberg Financial Systems		27,059
Wilshire Associates		208,075
Securities lending borrower rebates		2,016,563
Securities lending agent fees		<u>245,323</u>

Total other investment related expenses		<u>2,497,020</u>
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Total investment expenses	\$	<u><u>8,827,650</u></u>
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EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2004 AND 2003

	2004	2003
ASSETS		
Equity in County's pooled cash and investments	\$ 533,502	\$ 552,566
Investments:		
U.S. Government and agency obligations	224,583,856	157,608,576
Asset-backed securities	25,130,943	23,090,640
Municipal/Provincial bonds	745,819	3,214,422
Corporate bonds	283,610,976	183,702,695
Collateralized mortgage obligations	3,308,835	6,984,377
Commercial mortgage-backed securities	3,214,617	3,689,495
Common and preferred stock	1,319,682,926	833,740,238
Mutual and commingled funds	580,139	380,735,539
Short-term investments	96,168,794	117,775,423
Cash collateral received under securities lending agreements	300,257,113	233,445,083
Real estate holdings	3,697,613	7,410,841
Alternative investments	6,563,331	1,080,755
Total investments	2,267,544,962	1,952,478,084
Dividends receivable and accrued interest	6,630,325	6,228,359
Contributions receivable	3,893,796	3,012,702
Total assets	2,278,602,585	1,962,271,711
LIABILITIES		
Payable for collateral received under securities lending agreements	300,257,113	233,445,083
Benefits payable and other liabilities	2,726,501	2,283,349
Total liabilities	302,983,614	235,728,432
Net assets held in trust for pension benefits	\$ 1,975,618,971	\$ 1,726,543,279

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
ADDITIONS		
Contributions:		
Employer	\$ 61,927,029	\$ 55,205,855
Members	<u>14,761,912</u>	<u>14,769,579</u>
Total contributions	<u>76,688,941</u>	<u>69,975,434</u>
Investment Income:		
Net appreciation in fair value of investments	249,149,635	51,381,937
Dividends and interest	43,738,500	35,515,188
Income from securities lending activities	<u>2,834,615</u>	<u>3,041,932</u>
Total investment income	295,722,750	89,939,057
Less investment expenses	<u>8,827,650</u>	<u>7,764,561</u>
Net investment income	<u>286,895,100</u>	<u>82,174,496</u>
Total additions	<u>363,584,041</u>	<u>152,149,930</u>
DEDUCTIONS		
Retiree benefits	87,122,662	77,008,990
Disability benefits	5,031,935	18,559,929
Survivor benefits	19,491,388	4,811,473
Refunds	796,099	739,051
Administrative expenses	<u>2,066,265</u>	<u>2,007,326</u>
Total deductions	<u>114,508,349</u>	<u>103,126,769</u>
Net increase	249,075,692	49,023,161
Net assets - beginning of year	<u>1,726,543,279</u>	<u>1,677,520,118</u>
Net assets - end of year	<u>\$ 1,975,618,971</u>	<u>\$ 1,726,543,279</u>

RETIREMENT SAVINGS PLAN
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2004 AND 2003

	2004	2003
ASSETS		
Equity in County's pooled cash and investments	\$ 524,214	\$ 1,839,932
Investments	54,446,315	37,876,561
Contributions receivable	<u>684,896</u>	<u>558,878</u>
Total assets	55,655,425	40,275,371
LIABILITIES		
Accrued expenses	<u>39,996</u>	<u>60,652</u>
Net assets held in trust for pension benefits	<u>\$ 55,615,429</u>	<u>\$ 40,214,719</u>

RETIREMENT SAVINGS PLAN
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
ADDITIONS		
Contributions:		
Employers	\$ 6,468,353	\$ 6,798,553
Members	<u>4,208,196</u>	<u>3,750,518</u>
Total contributions	<u>10,676,549</u>	<u>10,549,071</u>
Investment income	6,222,567	1,819,663
Less investment expenses	<u>79,070</u>	<u>32,206</u>
Net investment income	<u>6,143,497</u>	<u>1,787,457</u>
Other income	<u>210,392</u>	<u>179,273</u>
Total additions	<u>17,030,438</u>	<u>12,515,801</u>
DEDUCTIONS		
Refunds	1,382,451	866,588
Administrative expenses	<u>247,277</u>	<u>210,398</u>
Total deductions	<u>1,629,728</u>	<u>1,076,986</u>
Net increase	15,400,710	11,438,815
Net assets - beginning of year	<u>40,214,719</u>	<u>28,775,904</u>
Net assets - end of year	<u>\$ 55,615,429</u>	<u>\$ 40,214,719</u>

DEFERRED COMPENSATION PLAN
STATEMENTS OF PLAN NET ASSETS
JUNE 30, 2004 AND 2003

	2004	2003
ASSETS		
Investments	\$ 239,923,463	\$ 198,702,884
Contributions receivable	<u>1,092,852</u>	<u>887,738</u>
Total assets and net assets held in trust for pension benefits	<u><u>\$ 241,016,315</u></u>	<u><u>\$ 199,590,622</u></u>

DEFERRED COMPENSATION PLAN
STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
ADDITIONS		
Contributions - members	\$ 21,610,024	\$ 21,062,049
Investment income	<u>29,455,876</u>	<u>4,659,572</u>
Total additions	<u>51,065,900</u>	<u>25,721,621</u>
DEDUCTIONS		
Member refunds	9,634,643	11,104,092
Administrative expenses	<u>5,564</u>	<u>16,967</u>
Total deductions	<u>9,640,207</u>	<u>11,121,059</u>
Net increase	41,425,693	14,600,562
Net assets - beginning of year	<u>199,590,622</u>	<u>184,990,060</u>
Net assets - end of year	<u>\$ 241,016,315</u>	<u>\$ 199,590,622</u>





INVESTMENT SECTION
Employees' Retirement System



EMPLOYEES' RETIREMENT SYSTEM

INVESTMENT PERFORMANCE, POLICY, STATISTICS AND ACTIVITY

For the year, the System's investment return was 17.16 percent. Return data for the System was calculated on a time weighted basis in accordance with the standards of the Association of Investment Management & Research (AIMR) by the System's custodian bank, The Northern Trust Company. Valuations are based on published national securities exchange prices, where available, and all valuations are reconciled between the various investment managers and the custodian bank. The following pages were prepared by the Board of Investment Trustees (Board) staff.

In the investment of public funds, adequate funding of employee retirement benefits at a reasonable and affordable cost is a paramount concern. An appropriate balance must be struck between risks taken and returns sought to ensure the long term health of the System. The Board has adopted an investment policy that works to control the extent of downside risk to which the System is exposed while maximizing the potential for long term increases in the value of assets.

Specific investment objectives include:

- To realize the actuarial assumed rate of return of 8 percent, annually.
- To manage portfolio risk so as to limit potential downside fluctuations in the value of the total System assets.
- To realize as high a rate of total return as possible consistent with the above.

To achieve these objectives, the following investment policies are employed:

- Allocate System assets to a broad array of investment sectors as follows: Domestic equities 45%, alternative investments 5%, international equities 15%, domestic fixed income 25% and TIPS 10%.
- Maintain the asset allocation stated above, within a +/-3% range.
- Monitor the individual investment manager's market value to ensure compliance with the Board's Manager Funding Policy.
- Evaluate the performance of all investment managers against their specific performance and style objectives and against the returns achieved by other similar managers.
- Evaluate the System's overall risk exposure and modify investments through rebalancing when necessary.

Charts and tables are enclosed indicating the System's:

- Asset allocation
- Investment managers with assignments
- List of largest assets held
- Investment performance for various periods

EMPLOYEES' RETIREMENT SYSTEM
INVESTMENT SUMMARY
ASSET ALLOCATION BY CATEGORY AND INVESTMENT MANAGER
As of June 30, 2004

Asset Class		Fair Value	% of Total
Manager	Investment Style	\$000	Fair Value
Domestic Equities			
BGI Russell 3000 Fund*	Passive Russell 3000 Index	\$ 240,286	12.2%
RhumbLine Advisors	Passive Russell 1000 Index	214,371	10.9%
Systematic Financial Mgt.	Active Large Cap Value	147,840	7.5%
Numeric Investors	Active Large Cap Core	141,694	7.2%
Goldman Sachs	Active Large Cap Growth	130,667	6.6%
Wellington	Active Small Cap Value	64,898	3.3%
Numeric Investors	Active Small Cap Growth	65,218	3.3%
Fidelity Investments*	Commingled Funds	580	0.0%
Alternative Investments			
Adams Street *	Private Equity Fund-of-Funds	4,018	0.2%
HarbourVest *	Private Equity Fund-of-Funds	2,546	0.1%
International Equities			
Marathon	Active EAFE	157,326	8.0%
Capital Guardian	Active EAFE	113,478	5.7%
Capital Guardian*	Active Emerging Mkts. Fund	38,849	2.0%
BGI EAFE Fund*	Passive EAFE Index	15,637	0.8%
Real Estate			
Total Real Estate Funds*	Active Equity	3,698	0.2%
Fixed Income			
JP Morgan	Active Core Plus	182,388	9.2%
BlackRock	Active Core Plus	208,354	10.6%
WR Huff	High Yield	109,013	5.5%
BGI US Debt Fund*	Passive Lehman Aggregate Index	20,333	1.0%
TIPS			
Bridgewater	TIPS	93,544	4.7%
Cash*			
	Active Short Term	19,714	1.0%
Total Assets**		<u>\$ 1,974,452</u>	<u>100.0%</u>

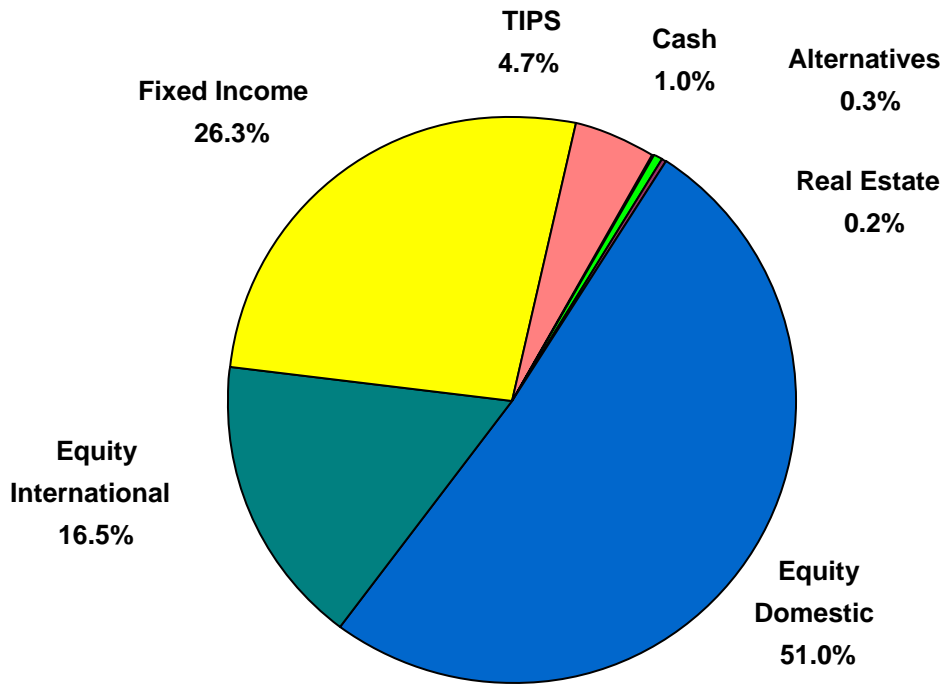
* Pooled Funds

**Without Cash Collateral and Contributions Receivable.

EMPLOYEES' RETIREMENT SYSTEM

Asset Allocation

June 30, 2004



EMPLOYEES' RETIREMENT SYSTEM
LIST OF LARGEST ASSETS HELD
JUNE 30, 2004

Fifteen Largest Equity Holdings	Shares	Value
Pfizer	536,100	\$ 18,377,508
Microsoft	472,600	13,497,456
Bank of America	150,094	12,700,954
Citigroup	259,202	12,052,893
General Electric	356,600	11,553,840
Exxon Mobil	246,800	10,960,388
Intel	378,200	10,438,320
Cisco Systems	331,800	7,863,660
Qualcomm	105,504	7,699,682
Federal National Mortgage Association	107,100	7,642,656
Johnson & Johnson	127,200	7,085,040
Wal-Mart Stores	133,400	7,038,184
Verizon Communication	191,300	6,923,147
Merck & Co.	145,700	6,920,750
International Business Machines	77,800	6,858,070

Fifteen Largest Fixed Income Holdings	Interest Rate	Maturity Date	Market Value
Federal National Mortgage Association Single Family August 15-year	5.000 %	September 15, 2033	\$ 30,148,500
Federal National Mortgage Association 30 year Pass-Throughs	5.500	September 15, 2033	22,421,011
United States Treasury Inflation Indexed Bonds	3.875	April 15, 2029	19,893,550
United States Treasury Notes	2.500	May 31, 2006	16,489,425
United States Treasury Inflation Indexed Notes	3.000	July 15, 2012	11,325,597
United States Treasury Inflation Indexed Notes	3.500	January 15, 2011	10,090,326
United States Treasury Inflation Indexed Notes	3.875	January 15, 2009	9,594,667
United States Treasury Inflation Indexed Bonds	1.875	July 15, 2013	8,715,454
Government National Mortgage Association	6.000	September 15, 2028	8,701,875
United States Treasury Inflation Indexed Notes	2.000	January 15, 2014	7,702,866
United States Treasury Notes	2.250	April 30, 2006	7,096,157
Federal Home Loan Mortgage Corp.	6.000	August 15, 2033	6,603,594
United States Treasury Inflation Indexed Bonds	3.625	April 15, 2028	5,404,016
United States Treasury Bonds	8.500	February 15, 2020	4,975,441
Federal National Mortgage Association	5.000	March 1, 2034	4,756,443

A complete list of the portfolio holdings can be obtained by contacting the Board of Investment Trustees office.

EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF INVESTMENT RESULTS
JUNE 30, 2004

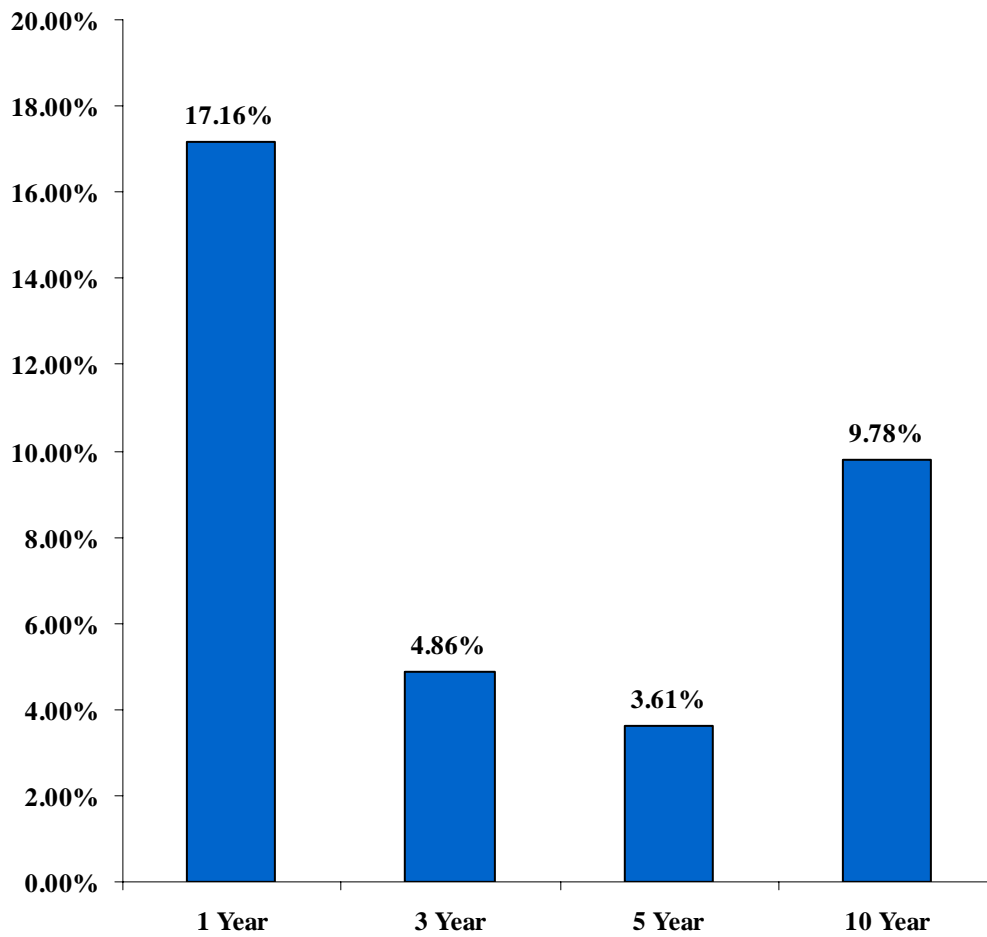
Asset Class Manager	1 Year	3 Year	5 Year
Domestic Equities			
BGI Russell 3000 Fund*	20.44 %	- %	- %
RhumbLine Advisors-Russell 1000	19.48	(0.22)	(1.51)
Systematic Financial Mgt.	21.78	3.22	4.63
Numeric Investors-Core	23.05	3.17	2.63
Goldman Sachs*	14.67	-	-
Numeric Investors-Small Cap	37.71	8.37	7.62
Wellington*	-	-	-
Combined Domestic Equities	21.70	2.07	0.68
**Russell 3000	20.46	0.15	(1.07)
Alternative Investments			
Adams Street*	(10.39)	-	-
HarbourVest*	-	-	-
International Equities			
Marathon*	41.35	-	-
Capital Guardian-Total*	28.76	4.28	-
Capital Guardian-Emerging Markets*	27.16	8.85	-
BGI EAFE Fund*	32.67	-	-
Combined International Equities	34.64	5.98	1.68
**MSCI All Country World X US	32.50	5.25	0.96
Real Estate			
Total Real Estate Funds	(13.10)	(5.38)	(0.46)
Fixed Income			
JP Morgan	0.80	6.69	7.44
BlackRock	0.97	6.94	7.49
WR Huff	12.80	7.87	5.68
BGI US Debt Fund*	0.33	-	-
Combined Fixed Income	3.31	7.07	7.17
**Policy Benchmark	2.32	7.20	6.71
Treasury Inflation Protection Securities			
Bridgewater*	4.98	-	-
Total Fund	17.16 %	4.86 %	3.61 %

Returns are calculated on a time weighted basis.

*Returns are not available for years indicated.

** Benchmark indexes.

EMPLOYEES' RETIREMENT SYSTEM
Compound Annual Return
on Investment Portfolio
As of June 30, 2004





ACTUARIAL SECTION
Employees' Retirement System

November 10, 2004

Board of Investment Trustees
Montgomery County Government Retirement System
101 Monroe Street
Rockville, MD 20850

Subject:

July 1, 2004 Actuarial Valuation Report

Dear Members of the Board:

Mercer Human Resource Consulting annually performs an actuarial valuation of the Montgomery County Employees' Retirement System for the Montgomery County Government. The most recent actuarial valuation performed was as of July 1, 2004. The purposes of this valuation were to:

- Review experience under the Plan for the year ending June 30, 2004
- Determine the liabilities of the Plan as of June 30, 2004
- Determine the contribution to be paid biweekly during the fiscal year ending June 30, 2006.

The actuarial information in this letter is provided in detail in our valuation report.

Valuation Results

Sections II through IV of the valuation report detail the results of the 2004 valuation, including a breakdown by employee group and plan. This valuation reflects the cost of plan changes as approved by the County resulting from the recent bargaining agreements. The changes improve the benefits for group G. There was no other change in plan provisions or actuarial assumptions from the 2003 valuation.

County Contributions

Contributions are computed using the Projected Unit Credit method of funding. The objective of this method is to fund each participant's benefits under the Plan, as they would accrue, taking into consideration future salary increases. Thus the total pension to which each participant is

Page 2

November 10, 2004

Board of Trustees

Montgomery County Government

expected to become entitled is broken down into units; each associated with a year of past or future credited service.

If all actuarial assumptions are met in the future and if there are no plan changes, the plan contribution as a percentage of the payroll covered by this plan is expected to increase. This is because the Optional Plans are closed to new non-public safety members; hence, the average age of active members is expected to increase in the future.

The July 1, 2004 actuarial valuation sets the County's contribution rates for the fiscal year ending June 30, 2006. The rates are set separately for public safety and non-public safety employee groups and will be applied to each group's total covered payroll for the fiscal year 2006. Thus, the exact dollar amount of the required contribution will not be known until the end of the fiscal year 2006. The contribution rates for fiscal year 2006 were determined based on the total payroll at July 1, 2004.

Investments

During the 2003-2004 plan year, the rate of return after investment expenses on fund assets was 16.7%. On a market value basis, the return was \$148.1 million more than the 8% assumed rate of return. This \$148.1 million gain is phased in over a five-year period. Gains and losses from 2003-2004 and prior years produced a net loss on an actuarial-value-of-assets basis. As of July 1, 2004, net investment losses of \$69.5 million had not yet been recognized in the actuarial value of assets.

The 2004 valuation was based on an actuarial value of assets of \$2,045,098,796.

We used the financial information provided by the County without further audit.

Aetna Contract

The value of the Aetna non-participating group-annuity contract is excluded from all calculations.

Page 3

November 10, 2004

Board of Trustees

Montgomery County Government

Actuarial Assumptions

In order to quantify plan liabilities, a number of actuarial assumptions need to be set. There was no change in assumptions in this valuation. Below are key actuarial assumptions:

Investment Return Rate	8.0% per annum
Salary Increase	Age-based table with an average increase of about 5.5% per annum
Social Security Wage Base Increase	4.5% per annum
Consumer Price Index	4.0% per annum

The actuarial assumptions used in the current valuation are described in detail in Section VI of the report.

Participant Data

Between June 30, 2003 and June 30, 2004, there was a 0.2% increase in the number of plan members. However, the number of active members decreased by 3.5%, from 5,876 to 5,670. The total payroll increased by 1.7%, from \$336.0 million to \$341.6 million.

Aetna provided the retiree data, including benefits. The County provided data on active and terminated vested members. This information would customarily not be verified by a plan's actuary. We have reviewed the information for internal consistency and we have no reason to doubt its substantial accuracy.

Supplementary Information

The July 1, 2004 actuarial valuation report also provides supplemental information, including the schedule of funding progress. This schedule is presented in the financial section of the County's Comprehensive Annual Financial Report. This information is intended to help users assess the System's funding status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and to provide a means for making comparisons with other public employee retirement systems.

Page 4

November 10, 2004

Board of Trustees

Montgomery County Government

The County extracted the information from the July 1, 2004 valuation report for the following schedules in the actuarial section and the statistical section of County's Comprehensive Annual Financial Report.

- Summary of Results
- System Contribution
- Membership
- Actuarial Assumptions and Methods
- Solvency Test

Actuarial Certification


All costs, liabilities, and other factors under the Plan were determined in accordance with generally accepted actuarial principles and procedures. The information provided has been determined in accordance with the provisions of Statement Numbers 25 and 27 of the Governmental Accounting Standards Board. The costs are calculated using an actuarial cost method that we believe is appropriate. The actuarial assumptions are reasonable in our opinion and represent our best estimate of the anticipated experience under the Plan.

The undersigned credentialed actuaries meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained in this report.

Respectfully submitted,



Aquil Ahmed, ASA, EA



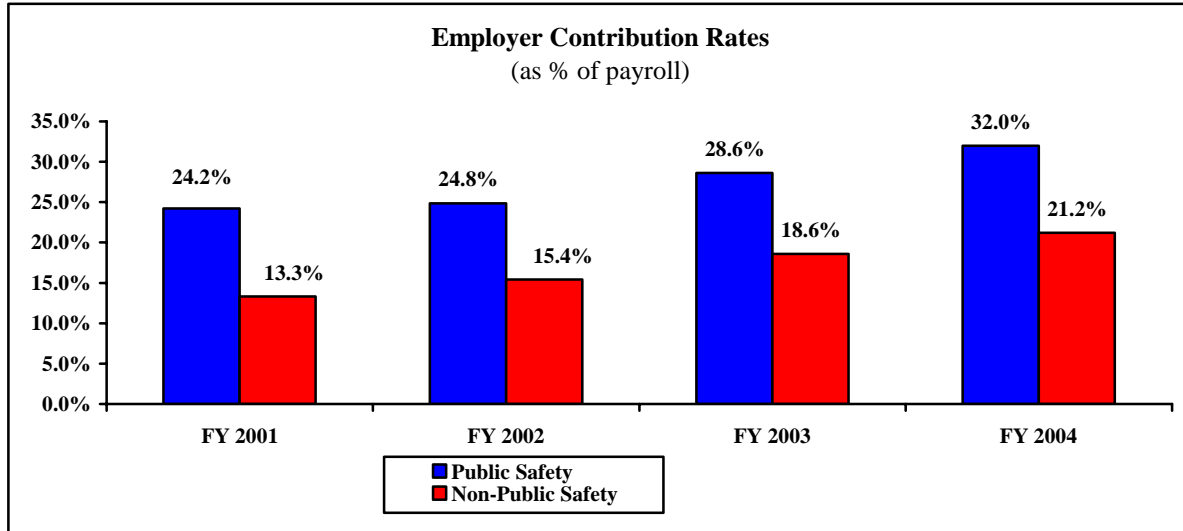
Douglas L. Rowe, FSA, EA

SUMMARY OF VALUATION RESULTS EMPLOYEES' RETIREMENT SYSTEM

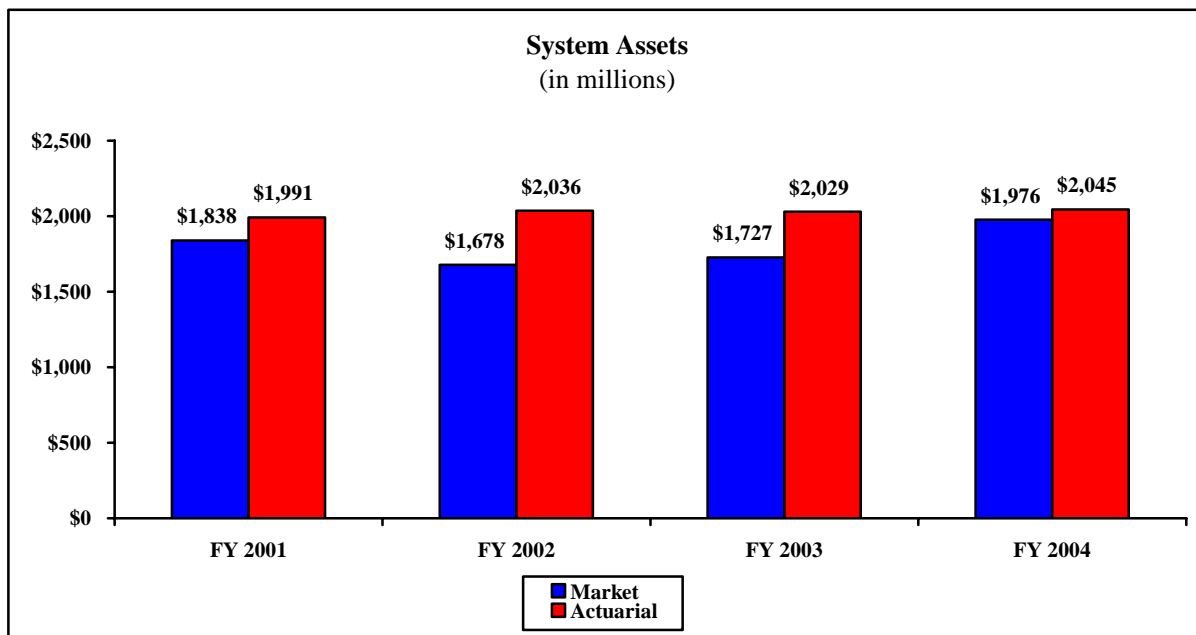
A. Overview

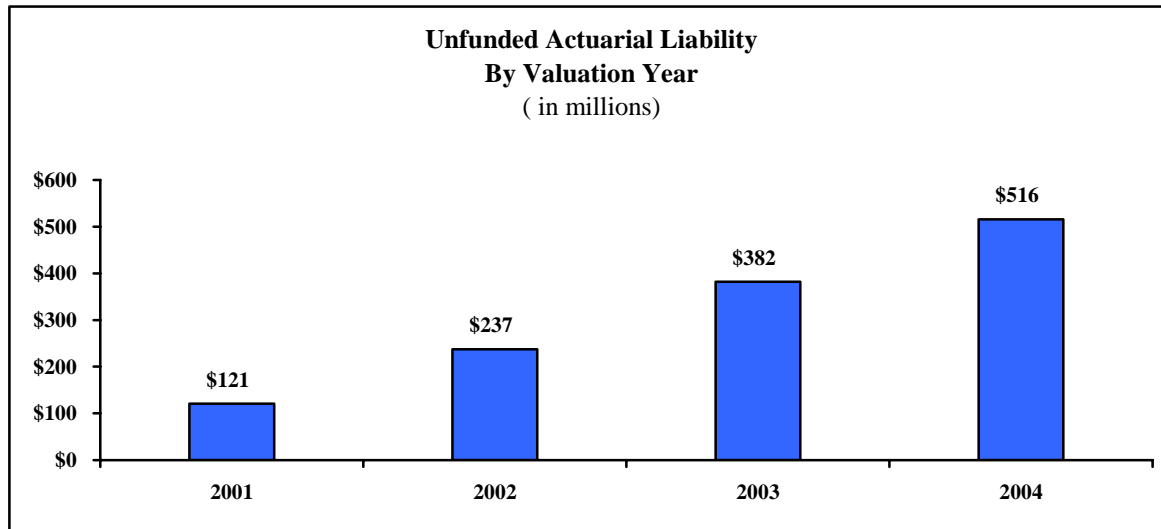
This report presents the results of our June 30, 2004 actuarial valuation of the Montgomery County Employees' Retirement System.

The major findings of the valuation are summarized in the following charts:

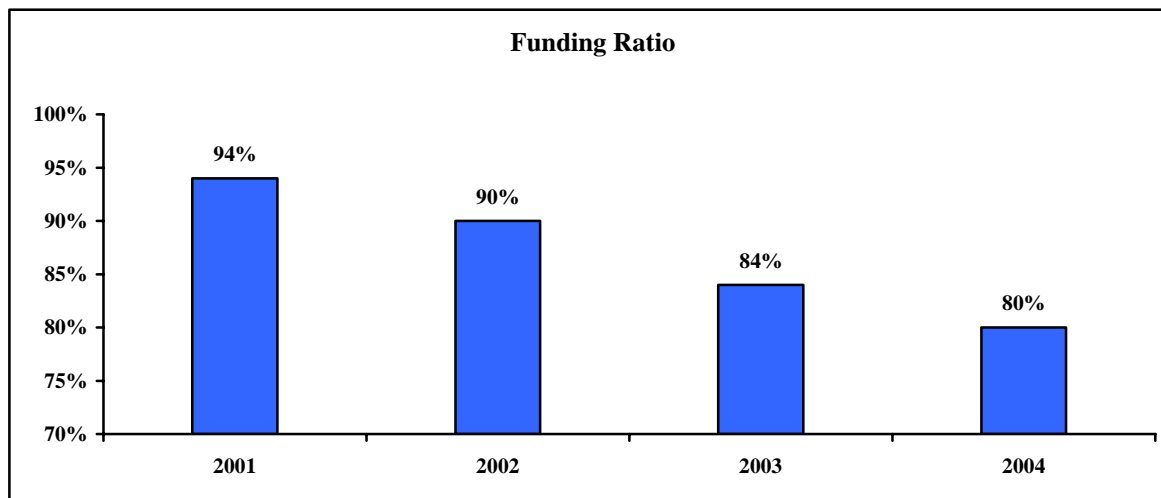


The majority of the increased rate of employer contribution in FY 2004 was due to increased plan benefits.





The unfunded actuarial liability increased significantly in FY 2004 due to investment losses that occurred from July 1, 2000 to June 30, 2003 and a higher-than-assumed salary increase during the year ended June 30, 2004.



The ratio of actuarial assets to the actuarial accrued liability remained below 100% this year.

B. Summary of Results

	<u>July 1, 2003</u>	<u>July 1, 2004</u>
Actuarial Liability		
a. Active Members	\$ 1,164,132,852	\$ 1,207,055,903
b. Retired Members and Beneficiaries	1,229,743,808	1,336,081,127
c. Vested Former Members	17,616,064	18,191,202
d. Total	<u>\$ 2,411,492,724</u>	<u>\$ 2,561,328,232</u>
Valuation Assets	\$ 2,029,314,438	\$ 2,045,098,796
Unfunded Actuarial Liability	\$ 382,178,286	\$ 516,229,436
Normal Cost		
a. Gross Normal Cost	\$ 57,104,110	\$ 59,231,455
b. Anticipated Employee Contributions	<u>\$ 15,083,571</u>	<u>\$ 15,322,174</u>
c. County Normal Cost (a -b)	\$ 42,020,539	\$ 43,909,281
Amortization Payment	\$ 35,424,430	\$ 45,759,329
County Contribution at date shown	\$ 77,444,969	\$ 89,668,610
County FY 2005/FY 2006 Contribution (as a % of covered payroll)		
Public Safety Employee	28.59%	31.96%
Non-Public Safety Employees	18.58%	21.22%

C. Valuation Highlights

1. System Assets

As of June 30, 2004, the System had assets, valued at market, of \$1.976 billion, as compared to \$1.727 billion at June 30, 2003. The increase of \$249 million was attributable to the following:

- a. An increase of \$77 million from employer and employee contributions;
- b. An increase of \$287 million from investment income; and
- c. A decrease of \$115 million due to the payment of benefits to System participants.

When measured on an actuarial basis, System assets were \$2.045 billion at June 30, 2004, and \$2.029 billion at June 30, 2003. The asset valuation method smoothes the fluctuations generated by intermittent market gains and losses. This method phases-in investment gains and losses arising during and after the 1994 fiscal year over a five-year period from the date established. Effective July 1, 1997, the calculation of the actuarial value of assets was changed to exclude the present value of estimated accrued contributions.

2. System Liabilities

The Unfunded Actuarial Liability increased \$134.0 million, from \$382.2 million at July 1, 2003, to \$516.2 million at July 1, 2004, as follows:

Actual Unfunded Liability at beginning of year	\$ 382,178,286
Actual Unfunded Liability at end of year	<u>516,229,436</u>
Increase in Actual Unfunded Liability	<u>\$ (134,051,150)</u>

The increase in Actual Unfunded Liability for the year ended June 30, 2004, is comprised of the following:

Increase due to loss on actuarial value of assets	\$ (107,257,715)
Decrease due to COLA gain	14,570,000
Increase due to demographic loss and other factors	(21,772,239)
Increase due to normal cost, interest and contributions	<u>(19,591,196)</u>
Increase in Actual Unfunded Liability	<u>\$ (134,051,150)</u>

3. System Contributions

Contributions to the System include a “normal cost” rate which covers the portion of projected liabilities related to service of members. In addition, an amortization payment is made to fund the unfunded liability related to changes made to benefits in previous years which are being funded over a specific period of time.

The increase in the employer contribution rate is attributable to the following:

	<u>Public Safety</u>		<u>Non- Public Safety</u>	
Employer contribution rate - June 30, 2003	28.59	%	18.58	%
Increase due to investment losses	2.74		2.17	
Increase due to actuarial gains & losses	.03		.80	
Increase due to plan amendment	.93		-	
Decrease due to gains from COLA	<u>(.33)</u>		<u>(.33)</u>	
Employer contribution rate - June 30, 2004	<u>31.96</u>	%	<u>21.22</u>	%

4. Membership

The active membership of the System decreased from 5,876 at June 30, 2003 to 5,670 at June 30, 2004. The System was closed to all new employees hired after October 1, 1994, except public safety bargaining unit employees. Inactive members, including retirees and beneficiaries, increased from 4,370 at June 30, 2003 to 4,559 at June 30, 2004 and the number of former members with vested rights decreased from 374 to 367.

SUMMARY OF ACTUARIAL ASSUMPTIONS AND METHODS EMPLOYEES' RETIREMENT SYSTEM

A. Funding Method

The funding method used for the System's valuation is the "projected unit credit" actuarial cost method. The objective of this method is to allocate the total pension benefit to which each participant is expected to become entitled at retirement to the participant's past and future service. The allocation is accomplished by applying the plan's accrual formula to projected final salary at retirement. An actuarial liability is calculated at the valuation date as the present value of benefits allocated to service prior to that date. The unfunded actuarial liability at the valuation date is the excess of the actuarial liability over the assets of the System.

B. Actuarial Value of Assets

The actuarial value of assets is used for purposes of determining the County's contribution to the System. The asset adjustment method dampens the volatility of asset values that could occur because of short term fluctuations in market conditions. Use of an asset smoothing method is consistent with the long term nature of the actuarial valuation process. Assets are valued at market value but with a phase-in of investment gains and losses arising after July 1, 1994, over a 5-year period. The gains and losses are net of expenses. Effective July 1, 1997, the calculation of the actuarial value of assets does not include the present value of accrued contributions.

**ACTUARIAL ASSUMPTIONS AND METHODS
EMPLOYEES' RETIREMENT SYSTEM**

A. Demographic Assumptions

1. Mortality

1983 Group Annuity Mortality Table Annual Deaths per 1,000 Members					
Age	Male Deaths	Female Deaths	Age	Male Deaths	Female Deaths
20	0	0	65	16	7
25	0	0	70	28	12
30	1	0	75	45	24
35	1	0	80	74	43
40	1	1	85	115	70
45	2	1	90	166	112
50	4	2	95	234	182
55	6	3	100	319	295
60	9	4	105	470	488

2. Termination of Employment (prior to retirement eligibility)

Annual Terminations per 1,000 Members		
Years of Service	Non-Public Safety	Public Safety
0 - 4	75 - 72	80 - 32
5 - 9	70 - 42	29 - 19
10 - 14	35 - 20	15 - 7
15 - 19	18 - 12	6 - 4
20 - 25	11 - 7	3 - 2
26 +	6	2

It is assumed that all participants who terminate with five or more years of service elect to receive a refund of their contributions with interest instead of a deferred benefit if they are less than age 41 when they terminate employment.

3. Disability

Non-Public Safety Employees			Public Safety Employees	
Annual Disabilities Per 1,000 Members			Annual Disabilities Per 1,000 Members	
Age	Male	Female	Male	Female
20	1	1	2	1
25	2	1	4	2
30	3	2	9	6
35	4	3	11	9
40	4	4	14	13
45	5	5	27	25
50	6	5	45	39
55	7	6	55	41
60	12	8	68	42
65	0	0	0	0

4. Deaths

Annual Deaths Per 1,000 Disabled Members		
Age	Male	Female
20	1	0
25	1	0
30	1	1
35	2	1
40	3	1
45	5	2
50	8	3
55	12	6
60	22	10
65	37	18

5. Retirement

<u>Age</u>	<u>Non-Public Safety Employees</u>	<u>Public Safety Employees Other than Group G</u>
41	0%	5% **
42	0	5**
43	0	5**
44	0	5**
45	1	5**
46	1	15**
47	1	15**
48	1	15**
49	1	15**
50	5 *	15**
51	5 *	15**
52	5 *	50
53	5 *	50
54	5 *	50
55	8	100
56	8	100
57	8	100
58	8	100
59	8	100
60	16	100
61	16	100
62	16	100
63	16	100
64	16	100
65	50	100
66	50	100
67	75	100
68+	100	100

* 15% at first eligibility for normal retirement if before age 60, and 20% at first eligibility for normal retirement (between ages 50 and 65) for SLT and Police Telecommunicators.

**For Group G members, 30% at first eligibility for normal retirement if before age 52.

Note: Rates only apply when employee is eligible to retire based on age and service.

6. Sick Leave Credit

Service credit is increased by 2.5% for members who receive their entire benefit from the County to account for additional credit from unused sick leave.

7. Assumption Changes

In August 2000, the System's actuary, Mercer Human Resource Consulting completed an experience study of the actuarial assumptions used for the five-year period ending June 30, 1999. All recommended assumptions were approved by management at that time.

B. Economic Assumptions

- | | |
|---|---|
| 1. Investment Return: | 8.0% compound per annum |
| 2. Cost-of-Living Increases: | 4.0% compound per annum |
| 3. Increase in Social Security Wage Base: | 4.5% compound per annum |
| 4. Salary Increase: | 4.0% compound per annum plus merit/promotional increase. Merit and promotional increases assumed to be based on age as shown below: |

<u>Age</u>	<u>Merit/ Promotional Increase</u>	
22	4.1	%
27	3.7	
32	3.0	
37	2.5	
42	1.4	
47	1.3	
52	1.1	
57	1.1	

ANALYSIS OF FINANCIAL EXPERIENCE

Gains and Loss in Accrued Liability During Years Ended June 30 Resulting from Differences Between Assumed Experience and Actual Experience

Type of Activity	2001	2002	2003	2004
Investment income (or loss)	\$ 17,187,273	\$ (76,656,381)	\$ (135,222,000)	\$ (107,257,715)
Combined liability experience	<u>(121,867,161)</u>	<u>(45,546,738)</u>	<u>(16,450,593)</u>	<u>(23,042,239)</u>
Gain (or loss) during year from financial experience	(104,679,888)	(122,203,119)	(151,672,593)	(130,299,954)
Non-recurring items	<u>121,889,595</u>	<u>-</u>	<u>-</u>	<u>-</u>
Composite gain (or loss) during year	<u><u>\$ 17,209,707</u></u>	<u><u>\$ (122,203,119)</u></u>	<u><u>\$ (151,672,593)</u></u>	<u><u>\$ (130,299,954)</u></u>

SOLVENCY TEST

Aggregate Accrued Liabilities

Valuation Date	(1) Active Member Contributions	(2) Retirees, Vested Terms, Beneficiaries	(3) Active Members (Employer Financed Portion)	Reported Assets	Portion of Accrued Liabilities Covered by Reported Assets		
					(1)	(2)	(3)
6/30/1998	\$ 121,197,443	\$ 899,019,607	\$ 639,816,988	\$ 1,496,651,390	100	100	74 %
6/30/1999	124,544,357	943,551,243	750,895,023	1,707,450,187	100	100	85
6/30/2000	136,181,427	1,014,314,792	781,418,094	1,911,114,401	100	100	97
6/30/2001	143,356,036	1,029,982,653	938,607,764	1,990,882,017	100	100	87
6/30/2002	146,500,545	1,125,070,362	1,001,608,309	2,036,100,709	100	100	76
6/30/2003	155,686,014	1,247,359,872	1,008,446,838	2,029,314,438	100	100	62
6/30/2004	160,523,789	1,354,272,329	1,046,532,114	2,045,098,796	100	100	51

SCHEDULE OF RETIREES AND SURVIVORS
During Years Ended June 30

	New Retirees and Disables	Survivors	Total
June 30, 1998	3,323	262	3,585
New retirements and disabilities	242	-	242
Survivors	(23)	23	-
Deaths/benefits ended	(85)	(7)	(92)
June 30, 1999	3,457	278	3,735
New retirements and disabilities	226	-	226
Survivors	(34)	34	-
Deaths/benefits ended	(84)	(8)	(92)
June 30, 2000	3,565	304	3,869
New retirements and disabilities	217	-	217
Survivors	(20)	20	-
Deaths/benefits ended	(85)	(12)	(97)
June 30, 2001	3,677	312	3,989
New retirements and disabilities	244	-	244
Survivors	(28)	28	-
Deaths/benefits ended	(108)	(10)	(118)
June 30, 2002	3,785	330	4,115
New retirements and disabilities	340	-	340
Survivors	(22)	22	-
Deaths/benefits ended	(83)	(2)	(85)
June 30, 2003	4,020	350	4,370
New retirements and disabilities	304	-	304
Survivors	(26)	26	-
Deaths/benefits ended	(99)	(16)	(115)
June 30, 2004	4,199	360	4,559



STATISTICAL SECTION

Employees' Retirement System

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF ADDITIONS BY SOURCE
JUNE 30, 2004

Fiscal Year	Plan Member Contributions	Employer Contributions	Employer Contributions % of Covered Payroll		Net Investment Income (Loss)	Total Revenues (Losses)
1999	\$ 10,477,566	\$ 47,462,625	16.82	%	\$ 165,709,869	\$ 223,650,060
2000	10,924,466	44,347,078	14.80		135,337,568	190,609,112
2001	11,291,541	43,345,296	14.91		(81,374,778)	(26,737,941)
2002	12,943,679	39,168,622	13.12		(124,177,457)	(72,065,156)
2003	14,769,579	55,205,855	17.69		82,174,496	152,149,930
2004	14,761,912	61,927,029	19.42		286,895,100	363,584,041

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF DEDUCTIONS BY TYPE
JUNE 30, 2004

Fiscal Year	Benefit Payments	Refunds of Contributions	Administrative Expenses	Total Expenses
1999	\$ 71,472,415	\$ 828,326	\$ 1,297,038	\$ 73,597,779
2000	76,387,491	860,699	1,219,552	78,467,742
2001	78,434,554	1,066,708	1,688,780	81,190,042
2002	85,322,387	681,375	2,092,364	88,096,126
2003	100,380,392	739,051	2,007,326	103,126,769
2004	111,645,985	796,099	2,066,265	114,508,349

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF BENEFIT PAYMENTS BY TYPE
JUNE 30, 2004

Fiscal Year	Retiree	Disability	Survivor	Total
1999	\$ 49,532,983	\$ 13,624,278	\$ 3,100,196	\$ 66,257,457
2000	53,463,287	14,716,815	3,188,218	71,368,320
2001	58,415,300	16,234,205	3,785,049	78,434,554
2002	64,030,235	17,250,631	4,041,521	85,322,387
2003	77,008,990	18,559,929	4,811,473	100,380,392
2004	87,122,662	19,491,388	5,031,935	111,645,985

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF RETIRED MEMBERS BY BENEFIT TYPE
JUNE 30, 2004

Fiscal Year	Retiree	Disability	Survivor	Total
1999	2,763	694	278	3,735
2000	2,831	734	304	3,869
2001	2,918	759	312	3,989
2002	3,002	783	330	4,115
2003	3,203	817	350	4,370
2004	3,348	851	360	4,559

MONTGOMERY COUNTY, MARYLAND
EMPLOYEES' RETIREMENT SYSTEM
SCHEDULE OF AVERAGE BENEFIT AMOUNTS
JUNE 30, 2004

Fiscal Year	Retiree	Disability	Survivor	Total
1999	\$ 17,927	\$ 19,632	\$ 11,152	\$ 17,740
2000	18,885	20,050	10,488	18,446
2001	20,019	21,389	12,132	19,663
2002	21,329	22,031	12,247	20,734
2003	24,043	22,717	13,747	22,970
2004	26,022	22,904	13,978	24,489

**SCHEDULE OF PARTICIPATING AGENCIES
AND POLITICAL SUBDIVISIONS**

Montgomery County Revenue Authority
Housing Opportunities Commission of Montgomery County
Town of Chevy Chase
Strathmore Hall Foundation, Inc.
Washington Suburban Transit Commission
Independent Fire/Rescue Corporations

Certain employees of the:
State Department of Assessments and Taxation
District Court of Maryland





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